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Tear Sheet:

Czech Gas Networks Investments S.a r.l.

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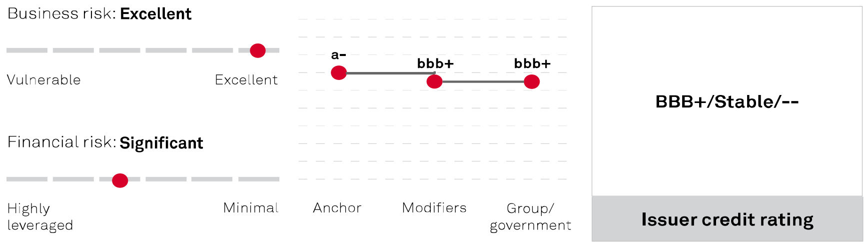
This report does not constitute a rating action.

We expect Czech Gas Networks Investments S.a r.l. (CGNI) will retain ample rating headroom over our forecast period, supported by the importance of gas in Czechia's switch from coal. We anticipate that funds from operations (FFO) to debt will remain robust, averaging around 15%-17% over 2025-2026, well above our minimum threshold of 9%. The company's expected cash flow generation is supported by solid distribution volumes, which are forecast to increase over the coming years as Czechia makes the transition away from coal, leaving much of the country's energy demand to be substituted by gas. Specifically, the Czech Republic has established strategic objectives to decrease the share of fossil fuels in primary energy consumption to 50% by 2030 and to 0% by 2050, with plans to phase out coal for electricity and heat production by 2033. The expected substitution to gas is supported by the fact that the country is not well-positioned geographically for renewables penetration. In the greater transition away from fossil-fueled energy we understand that CGNI is investing in projects to enable the integration of hydrogen in the existing distribution network, although the speed of the transition to hydrogen in Czechia is currently uncertain, and the majority of the company's investment plan is related to reinvestments into the existing regulated natural gas grid.

CGNI benefits from a strong market position and stable regulated earnings, with the new regulatory period starting in January 2026. CGNI's low-risk gas distribution activities in a predictable and supportive regulatory environment support our 'BBB+' long-term issuer credit rating on the company. CGNI, through its subsidiary GasNet, is the largest gas distribution company in the Czech Republic, with about 90% of EBITDA stemming from regulated gas distribution operations. It covers about 80% of the Czech market and services 2.3 million off-take points. We view the current five-year regulatory framework ending December 2025 as very supportive, as it is transparent, relatively stable, and predictable, and we understand that the changes made in the methodology for the upcoming regulatory period spanning 2026-2030 (RP6) continue to support our assessment of the framework, which we could view more in line with Western European frameworks. Changes in RP6 from RP5 include the addition of a bonus element to the weighted-average cost of capital (WACC), which can allow companies to obtain up to a 1.5 percentage point increase to the WACC if certain key performance indicators (KPIs) are achieved, leading to a total WACC of 8.4%. In line with the new methodology, we expect the regulatory asset base (RAB) to increase to about Czech koruna (CZK) 71.8 billion in 2026 (about €3 billion) from CZK65.1 billion at year-end 2023 (about €2.6 billion).

Our assessment includes the expectation that CGNI will remain a strategic subsidiary of CEZ, but the rating is constrained by the high dividend distribution policy. We view CGNI as moderately strategic for CEZ (A-/Stable/--). CEZ's acquisition of the 55.21% stake of CGNI in 2024 displays the continuous relevance of gas distribution assets in Czech Republic as gas will continue to play strategic role in coal replacement in Czechia in both the heat and power sector as well as in stabilizing the electricity grid. However, the main rating constraint for CGNI remains its aggressive dividend policy, even though we view the shareholder commitment to the rating as supportive. We expect CGNI's free operating cash flow to remain positive at about CZK5.0 billion over 2025-2026 due to strong cash flow generation and relatively low capital expenditure (capex) compared with peers. As CGNI's financial policy is to distribute all reasonably available cash to shareholders, we expect this will result in volatile negative discretionary cash flow of negative CZK2 billion to negative CZK100 million over 2025-2026, given that shareholder remuneration will be about CZK5.0 billion-CZK7.0 billion over the same time period. That said, we have observed willingness from the shareholders to adjust or suspend dividends if needed to uphold the current rating level, most recently in 2022.

Ratings Score Snapshot



Company Description

CGNI has two operating subsidiaries, GasNet (representing 90% of revenue) and Grid Services (10%). GasNet is the country's largest gas distribution system operator, with a market share of about 80%. It owns and operates about 65,000 kilometers of distribution networks, effectively distributing about 60 terawatt hours of gas per year to more than 2.3 million customers. Grid Services provides maintenance, development, metering, and dispatch for GasNet's distribution infrastructure.

Currently, CGNI is owned by CEZ with a majority stake of 55.21%. BCI and Allianz are the other two shareholders, holding respective shares of 26.29% and 18.5%.

Outlook

Our stable outlook incorporates our view that CGNI will continue generating stable cash flows from its regulated gas operations and maintain FFO to debt on average of 13%-14%, well above the 9% downside threshold for the current rating.

Downside scenario

We see the likelihood of a downgrade as remote because it would occur if we were to downgrade CEZ by two notches to 'BBB' or if we were to revise down our view of CGNI's stand-alone credit profile (SACP) by two notches to 'bbb-', neither of which we expect.

We would consider revising down the SACP by one notch to 'bbb' if we believed that CGNI's FFO to debt would move below 9%, or if its debt to EBITDA stayed above 7.0x, which could occur because of:

- Weaker operating performance or reduced profitability, from, for example, cost overruns compared with the regulatory assumptions or the methodology for next regulatory period proving less supportive than currently expected.
- A more aggressive shareholder policy.

Upside scenario

An upgrade to 'A-' could occur if:

- We upgraded CEZ;
- CGNI displayed a supportive financial policy implying a commitment to maintain FFO to debt of at least 14% sustainably; or
- If we observed a continuously supportive regulatory framework for the 2026-2030 period, which we would view in line with other frameworks we currently assess as strong.

Key Metrics

Czech Gas Networks Investments S.a r.l.--Forecast summary*

Period ending	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Mil. CZK)	2022a	2023a	2024e	2025f	2026f
EBITDA	9,470	7,861	10,500-11,000	10,500-11,000	12,000-12,500
Funds from operations (FFO)	7,236	5,818	8,500-9,000	8,000-8,500	9,500-10,000
Capital expenditure (capex)	3,736	4,414	5,000-5,500	5,200-5,700	6,000-6,500
Shareholder remuneration**	1,693	3,463	4,000-4,500	6,500-7,000	4,800-5,300
Debt	53,164	56,693	53,000-58,000	55,000-60,000	54,000-59,000
Adjusted ratios					
Debt/EBITDA (x)	5.6	7.2	4.8-5.5	5.0-5.7	4.3-4.9
FFO/debt (%)	13.6	10.3	14.7-17.0	13.3-15.5	16.1-18.5

*All figures adjusted by S&P Global Ratings. **Shareholder remuneration includes interests on shareholder loan CZK--Czech koruna. a--Actual. e--Estimate. f--Forecast.

Financial Summary

Czech Gas Networks Investments S.a r.l.--Financial Summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023
Reporting period	2020a	2021a	2022a	2023a
Display currency (mil.)	CZK	CZK	CZK	CZK
Revenues	14,594	15,069	13,981	13,047
EBITDA	9,156	10,487	9,470	7,861
Funds from operations (FFO)	7,227	8,387	7,236	5,818
Interest expense	1,963	1,469	1,493	1,702
Cash interest paid	1,197	1,069	1,497	1,638
Operating cash flow (OCF)	6,144	7,172	7,132	5,009
Capital expenditure	4,352	4,520	3,736	4,414
Free operating cash flow (FOCF)	1,792	2,652	3,396	595
Discretionary cash flow (DCF)	(765)	(6,121)	657	(2,868)
Cash and short-term investments	1,741	1,376	4,040	1,194
Gross available cash	1,741	1,376	4,040	1,194
Debt	43,630	56,168	53,164	56,693
Common equity	45,845	34,729	31,009	24,056
Adjusted ratios				
EBITDA margin (%)	62.7	69.6	67.7	60.3
Return on capital (%)	1.6	3.7	3.1	1.4
EBITDA interest coverage (x)	4.7	7.1	6.3	4.6
FFO cash interest coverage (x)	7.0	8.8	5.8	4.6
Debt/EBITDA (x)	4.8	5.4	5.6	7.2
FFO/debt (%)	16.6	14.9	13.6	10.3
OCF/debt (%)	14.1	12.8	13.4	8.8
FOCF/debt (%)	4.1	4.7	6.4	1.0
DCF/debt (%)	(1.8)	(10.9)	1.2	(5.1)

Peer Comparison

Czech Gas Networks Investments S.a r.l.--Peer Comparisons

	Czech Gas Networks Investments S.a.r.l.	Madrileña Red de Gas S.A.U.	Northern Gas Networks Ltd.	2i Rete Gas
Foreign currency issuer credit rating	BBB+/Stable/--	BBB-/Negative/A-3	BBB+/Stable/--	BBB/Watch Pos/A-2
Local currency issuer credit rating	BBB+/Stable/--	BBB-/Negative/A-3	BBB+/Stable/--	BBB/Watch Pos/A-2
Period	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2024-03-31	2024-12-31
Mil.	CZK	CZK	CZK	CZK
Revenue	13,047	3,836	15,914	22,554
EBITDA	7,861	2,830	10,164	15,845

Czech Gas Networks Investments S.a r.l.--Peer Comparisons

Funds from operations (FFO)	5,818	2,206	7,464	11,427
Interest	1,702	566	1,863	2,088
Cash interest paid	1,638	526	1,298	2,037
Operating cash flow (OCF)	5,009	1,854	6,692	13,966
Capital expenditure	4,414	343	5,853	9,109
Free operating cash flow (FOCF)	595	1,511	839	4,858
Discretionary cash flow (DCF)	(2,868)	1,511	(2,049)	1,708
Cash and short-term investments	1,194	1,730	1,156	2,033
Gross available cash	1,194	1,730	1,156	2,033
Debt	56,693	20,859	52,780	81,551
Equity	24,056	18,576	20,594	36,532
EBITDA margin (%)	60.3	73.8	63.9	70.3
Return on capital (%)	1.4	5.2	10.4	8.5
EBITDA interest coverage (x)	4.6	5.0	5.5	7.6
FFO cash interest coverage (x)	4.6	5.2	6.7	6.6
Debt/EBITDA (x)	7.2	7.4	5.2	5.1
FFO/debt (%)	10.3	10.6	14.1	14.0
OCF/debt (%)	8.8	8.9	12.7	17.1
FOCF/debt (%)	1.0	7.2	1.6	6.0
DCF/debt (%)	(5.1)	7.2	(3.9)	2.1

Liquidity

We assess CGNI's liquidity as adequate, as we anticipate that liquidity sources will exceed uses by approximately 1.1x over the next 12 months, starting from Jan. 1, 2025, even in the event of a 10% decline in EBITDA. The headroom under the adequate assessment is limited primarily due to the aggressive dividend policy. The company does not have any debt due until 2026 and the revolving credit facility matures in 2028. We believe the group has a sound relationship with banks, and so long as the credit rating remains investment grade, no financial covenants apply.

Principal liquidity sources

- CZK2.2 billion available cash.
- Undrawn committed facilities of about CZK0.7 billion.
- FFO of about CZK10 billion.

Principal liquidity uses

- No debt maturity before 2026.
- About CZK5 billion-CZK6 billion capex.
- Roughly CZK6.0 billion of shareholder distributions, including interest on the shareholder loan.

Environmental, Social, And Governance

Environmental factors are a moderately negative consideration in our credit analysis of CGNI, similarly to other European gas networks. CGNI is the Czech Republic's largest gas distribution system operator and represents about 80% of gas distributed in the country. We see the company as exposed to uncertainties surrounding the future role of gas in Europe as countries reduce carbon dioxide emissions. That said, we note the country will rely on gas to replace coal in the energy mix, with gas eventually representing 50% of energy supply in 2030 (versus 17% for coal), compared with 2023 levels of 28% for coal, and 15% for natural gas.

Rating Component Scores

Foreign currency issuer credit rating	**BBB+/Stable/--**
Local currency issuer credit rating	**BBB+/Stable/--**
Business risk	**Excellent**
Country risk	Intermediate
Industry risk	Very Low
Competitive position	Strong
Financial risk	**Significant**
Cash flow/leverage	Significant
Anchor	**a-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile	**bbb+**

Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

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